Degree of Government Regulation In the
Milk Industry: Three Alternatives 1/

For these few minutes, I have been charged with the job of discussing how three alternative forms of government regulation might be constructed to better serve the dairy farmer. The alternative forms include Federal milk orders, marketing boards, and public utility type regulation.

Two preliminary questions need to be recognized. First, what kinds of problems in the milk industry are these alternatives supposed to resolve? Second, what are the specific purposes that each of the alternatives is supposed to serve?

Without getting us bogged down on long statements of the problems in the milk industry, I'd simply note that four problem areas were recognized in the base book for this Conference -- Who Will Market Your Milk? The problem areas include--

1. Income-Price problems - both price level and price stability.
2. Equity problems affecting milk producers - especially as related to non-member situations and pooling questions.
3. Public challenges to dairy pricing institutions.
4. Price determination problems - including matters such as formula pricing, component pricing, and Grade B conversion.

The obvious emphasis of the report relates primarily to the first two problems -- price-income and equity, while the latter two problems are skirted for the most part.

1/ Robert E. Jacobson, Department of Agricultural Economics, The Ohio State University, for presentation at the 20th Southwest Milk Marketing Conference, Dallas, Texas, May 3-4, 1978.

The essential purpose of all of the alternatives, and especially the three assigned to me this morning, is this: To provide the dairy farmer with a stronger and more stable base for marketing his products and to improve his income position by market actions that affect milk prices positively. Somewhat implicit in all of this is that milk producers would exert significantly greater control over the production, processing, and marketing of milk and its products.

My intent this morning is to develop the Federal order program alternative. I plan to deal with the marketing board and public utility only briefly because they obviously represent much more academic possibilities than a conference like this is geared to.

Public Utility Regulation --- The concept of public utility regulation in the milk industry is not really very radical, i.e., it's not very new. Among others, John D. Black evaluated the possibility in his 1935 book entitled The Dairy Industry And the AAA.

Public utilities, by definition, are privately owned and operated, but government regulation extends to their operations, especially with regard to rates and earnings. The primary basis for regulation of the public utility type is that the public welfare is vitally affected. Milk has usually met this test.

The concept of 'natural monopoly' is usually associated with public utility regulation. This simply means -- and railroads and electric power companies are prime examples of this -- that there is a pronounced tendency toward monopoly control of a given market because of a high fixed investment and decreasing costs. Natural monopoly does not describe the milk situation, at least in production; but the increasing concentration and economies of size in fluid milk processing and to a lesser extent in manufactured dairy product processing are a clear push in the direction of natural monopoly.

In the base book, we recognized three advantages of public utility regulation of the milk industry. These included (1) reduced marketing costs, (2) realization of adequate returns for the regulated interests, and (3) attainment of increased market stability and security for the milk producer.

Four disadvantages of public utility regulation were noted: (1) fewer marketing options for producers, (2) further impact of public decision making, (3) structural rigidity of the production and processing sectors, and (4) reduced innovations across the board.

Marketing Board -- So much for the public utility route -- what about the potentials for a Milk Marketing Board?

When we talk about Marketing Boards, we usually look to the Canadian experience because there are more than 120 such boards in Canada covering everything from milk to maple syrup to wheat.

A marketing board is a producer oriented (controlled), compulsory marketing organization that has full legal authority to perform a number of specific marketing operations. That's all we need to know in order to know right away that the marketing board approach is something more powerful and something we're not used to in U. S. agriculture.

We can probably get a better feel of the power of a Milk Marketing Board by assuming that we had a national supply management program for milk with severe penalties for over-production. For example, any of you who read the April 10 issue of Hoard's Dairyman and noted the article, "How Canada Solved Its Milk Surplus Problem," read that on April 1, 1976, the penalty for over-quota milk was raised from $4.00 to $8.60 per cwt., and that "some dairymen owed the government for April deliveries."

That is why we say in the base book, "Philosophically, marketing boards conflict with many basic concepts in our free enterprise system. Marketing boards are legalized monopolies and competition within the industry would be severely restricted. For this reason, the powers and limitations of the board must be spelled out in law."

Marketing boards go beyond Federal orders in their functions. Marketing boards go beyond cooperatives in their membership -- they are not open-shop voluntary; they are union shop involuntary.

Marketing boards in Canada have often had the power to regulate production, buy and sell all products placed on the market, control prices, engage in product promotion, and operate or manage different types of services such as hauling, testing, artificial insemination, and quality control.

We have advanced in the base book what may sound to you like a curious comment: "Efficiency in a competitive economy (like ours) is often sacrificed to preserve competition." The comment simply takes note of the fact that we have a lot of route duplication, facility duplication, people duplication -- to maintain competition situations. For example, I know a procurement manager at an Ohio milk cooperative who makes sure that there are two or more bulk tank trucks in all areas of the milkshed to make sure that every contract hauler has some kind of a competitive restraint to contend with. A marketing board would have authority to dissolve competition for efficiency purposes -- and the efficiencies would be measured in terms of higher net incomes to milk producers.

It was noted in the base book again that "a properly managed marketing board could rationalize milk hauling patterns, centralize market services where economies of scale are important (e.g., butterfat and protein testing), plan investment in processing capacity, promote the entire dairy industry, and generally reap many of the efficiencies inherent in a monopolistic position."

This leaves us in a sense with the classic confrontation, freedom vs. price/income. Is there a better way of doing it than we are doing it now? There may be, but most of us are probably persuaded that public utility and marketing board are not in the mainstream of thinking about better ways to market milk. So we turn to Federal milk market orders.

Federal Market Orders -- The acceptance, the impact, and the performance of Federal milk orders are pretty well recognized by all of us. The program has been with us for more than forty years; approximately 80 percent of the Grade A milk in the U. S. is subject to this regulation at 1,300 plants in 47 separately defined markets; and 122,000 milk producers are the "beneficiaries" of this particular program.

For the Federal order program to serve as an alternative in our discussion here, we have to look beyond the traditional operations of milk orders and pursue the following two questions ---

1. From a producer viewpoint, are there things that Federal orders could do better?
2. From a producer viewpoint, are there things that Federal orders are not doing that they should get into?

I suppose that most everybody in the milk industry has their own shopping list of things the Federal order program should either be doing or doing better. And it's also pretty safe to note that the Dairy Division has a shopping list equally long which translates essentially, "Here's why we can't do it or why it shouldn't be done!"

Some of the possibilities for pushing Federal orders further in the direction of advantaging milk producers were noted in the base book ----

1. Further market order consolidation, basically to get a more equal sharing of Class I sales and reserve supplies among markets.
2. Formal implementation of standby pool arrangements across the entire order program.
3. Payment of all order obligations by handlers directly to the Market Administrator, who in turn would distribute the money to producers through their chosen channels.
4. Adoption of economic formula pricing for Class I milk to better reflect economic conditions.
5. Adoption of product price formulas for Class III milk to gain more price stability.
6. Implementation of a disciplined production control authority that would limit producer entry and have substantial penalties for over base production.
7. Formulation of a multiple component pricing plan that would distribute pool money more equitably, and through possible demand shifting, increase the revenue to milk producers.
8. Authorization of a schedule of market service charges that handlers would be required to pay for functions performed by cooperatives that benefit the handlers.

In the base book, we didn't begin to exhaust the possibilities of how Federal orders might be exploited, nor did we push any particular cause. Some additional possibilities that Federal orders might come to grips with need to be recognized.

1. Improved coordination between the support price and Class III prices in periods of excess milk supplies.

2. More efficient and more effective administrative machinery for receiving payment from processors who are delinquent in their payments for milk to the pool or to cooperatives.
3. A more rigorous policy of cooperative qualification in the market order program to reduce the incidence of rump groups diluting producer efforts.
4. Extension of the Federal order program to cover all Grade A milk in the United States.
5. Adjusting (increasing) Class I differentials in direct relation to changing transportation costs.
6. Increased efforts directed at maintaining present provisions that require handlers reconstituting nonfat dry milk to pay a Class I skim milk equivalent.

I am certain that the listing so far doesn't even scratch the surface on some of the ideas -- and even aberrations -- that the Dairy Division has to contend with as it digests the public hearing record and receives different characters at the South Building. But at least it puts a lot of hay on the ground.

There are a lot of reasons - and very good reasons - why the Federal order program should not move further and should not be pushed further in the direction of serving producers' interests. But it was not a purpose of the Producer Initiatives Project to bog down on why things should not be done, but rather to focus on things that might be done.

At the Battle of Mobile Bay in 1864, Admiral Farragut echoed the famous words, "Damn the torpedoes - full speed ahead!" In the same way, we'll plow ahead with the initiatives. I probably shouldn't add the footnote that Farragut had his ship sunk from under him during that battle.

Let's develop a couple of things that might be done in the Federal order program that gives the whole area of initiatives a little more substance. The two areas I would suggest to you are (1) marketing service charges by order regulation, and (2) multiple component pricing that would be specified in order regulations. These two areas are mentioned here because (1) the milk producer sector generally has lacked initiative in pursuing these matters, and (2) the Dairy Division has done an effective job of deflecting these matters from reaching any effective decision point. [My reservations about these two issues are submerged for the sake of illustrating potentials for producers in the Federal order program].

1. Marketing Service Charges -- I continue to be impressed with the amount of confusion that surrounds the marketing service charge issue. And where there's confusion, it's pretty hard to take any initiative. There are a few people that seem to survive on the premise "Seldom right, but never in doubt!" -- but that doesn't describe advances in marketing for milk producers.

Many services are performed in the marketing of bulk fluid milk. Different parties perform these services --- different parties benefit from these services. When we talk about marketing services specifically, we are talking essentially about services performed by a seller cooperative that benefit a buyer handler. The primary marketing service includes balancing milk supplies for a market throughout the year including the provision of specific quantities of quality milk to handlers when and where it is needed, and taking the responsibility for all excess supplies. Marketing services must not be confused with marketwide services such as bargaining, promotion, and lobbying that benefit all producers on the market.

Marketing services are associated with marketing service charges. Marketwide services are sometimes associated with cooperative payments --- and coop payments are outside of our considerations.

The offering of marketing services by cooperatives to handlers has become widely accepted. It's tough to find a processor's fieldman in many markets anymore, and normal operations call for cooperatives to handle market reserves as examples. But the provision of marketing services costs money. And for various reasons, and at various times, cooperatives may not be able to recover the costs. Fluctuating super-pool premiums, competing cooperatives in the market, and non-member situations all get in the way of a cooperative charging the full rate on the services it provides handlers.

But I'm not here to dwell on the problem - I am here to dwell on pushing the Federal order program to resolving the problem.

General opinion seems to be that there is authority in the Agricultural Marketing Agreement Act of 1937 to stipulate marketing service charges in Federal orders, so long as a handler has the option of selecting those services.

So, we have a problem, there is authority - but nothing seems to be happening. It's at a juncture like this that there seems to be a fundamental potential for producer initiative.

While the Dairy Division has seemed to invite the introduction of marketing service charges, it has at the same time raised a number of large and smokey questions that have seemed to frustrate the producer sector. (1) Should marketing service charges be implemented on a market by market basis, or in all Federal order markets? (2) How should service costs be estimated, and how can the value to handlers be recognized in the charges? (3) Should service charges be written in as maximums, or minimums, or fixed? (4) Are there superior alternatives to marketing service charges, such as lower reserve milk prices?

Again I would ask - where is the producer initiative here? The Federal order program has had to contend with one heck of a lot more difficult questions over its history than those posed on the marketing service charge issue. The questions can be answered - they can be answered quickly and appropriately. --- The focus of this project and the project manual Who Will Market Your Milk? is to get producers to recognize possibilities such as this and to take positive actions on the possibilities.

2. Multiple Component Pricing -- A second issue where more producer initiative is essential in pushing the Federal order program is that of multiple component pricing. In the Federal order program, producers are paid on a cwt.-butterfat basis, and milk usage is accounted for at the plant on a fat-skim basis. In both instances, skim milk carries a constant value regardless of its SNF test. That made sense when we only had a Babcock test. It made sense when most skim milk was fed to farm animals. And it made sense when butterfat dominated the value of all milk and dairy products. But none of these factors are real in the milk industry in 1978. So we find ourselves high on another cycle of interest in the testing and pricing of milk on a SNF or protein basis as well as on milkfat.

Now there are complications in the process of adopting component pricing well before the matter becomes pertinent to Federal order decision. The Food and Drug Administration messes it up somewhat with its low 8.25 percent minimum solids-not-fat standards of identity for fluid milk drinks. And milk producers themselves have been divided on the issue, although it now appears that the National Milk Producers Federation will soon release a report that endorses component pricing. Further, the report may specify a plan that could (1) be handled as an amendment in all Federal milk orders, and (2) would meet a key Dairy Division requirement that the plan be applied to class prices charged handlers as well as to prices paid farmers for milk.

With this much producer initiative already energized, it's clear that something significant can be done in moving the Federal order program on multiple component pricing. Of course, there are still those large and smokey questions that come out of the Dairy Division that can frustrate the producer sector. (1) Will the plan be implemented in a single market or in all markets? (2) Will component pricing bring on additional SNF in a market already burdened with SNF? (3) Will fluid handlers seek milk supplies testing lower in protein/ SNF? (4) Are milk producers sufficiently unified to take this initiative? (5) Will the plan be legal in terms of both paying producers and charging processors? Again, I believe that there are pragmatic answers to all of these questions, and component pricing represents an initiative that the producer sector can move on as it uses the Federal order program.

Eight alternatives were recognized in the project. I have dealt briefly with two of them -- public utility and marketing board -- and a little more extensively with a third - the Federal order alternative. Within a given alternative, there are a substantial number of initiatives that might be elevated to better serve producer purposes. Within the Federal order alternative, the initiatives of marketing service charges and multiple component pricing were treated in more detail.

The perspective we are offering is not one of "Why do it?" but rather "Why not ...?". It is a little bit closer to Farragut's, "Damn the torpedoes, full speed ahead!" It's easy to get caught up in what some people call the 'paralysis of analysis' and finally get nothing done but set up further study committees. We hope that within the alternatives and within the initiatives, there are programs that the milk producer sector will undertake that will better serve their economic objectives. Another way of expressing it is that we would like to see milk producers adopt the slogan of the prune juice interests -- "Don't just sit there - do something!"